2005/06 INVESTMENT STRATEGY

INTERNATIONAL MARKETING & PRODUCT DEVELOPMENT PROGRAMS

NOVEMBER 2004

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PREFACE:

British Columbians want abundant sustainable forests, an internationally competitive forest industry, and stable resource communities. Forestry Innovation Investment Ltd. (FII) is helping ensure a vital, growing, and sustainable forest sector for the benefit of the people of British Columbia.

Forestry Innovation Investment Ltd. (FII) is an agency of the Government of British Columbia, responsible for the British Columbia Government investments in:

- forest sector international marketing,
- forest product development activities, and
- forest practices and market acceptance advocacy.

The overall goal of FII funding programs is to contribute to the development of a robust and globally competitive forest industry by developing new products, promoting new and existing products, maintaining and growing existing markets and aggressively pursuing new and emerging markets.

This document represents the 2005/06 Investment Strategy for Forestry Innovation Investment's **International Marketing and Product Development Programs**.

This Investment Strategy highlights the markets and key activities that FII has identified as a priority for funding during 2005/06 to benefit and enhance BC's various forest sectors, while maximizing the return on investment of public funds.

BACKGROUND:

Forestry Innovation Investment Ltd. (FII) manages investments on behalf of the Government of British Columbia to support programs and initiatives to improve international competitiveness and increase the level of benefit derived from the Crown's forest resource.

FII investments focus on joint public-private projects of general benefit to the BC forest sector, or sub-sectors. FII works in partnership with the Government of Canada and BC-based forestry associations and individual companies. Details on FII are available at http://www.bcfii.ca.

Since its inception in April 2002, FII has funded approximately $27 million in industry and federal cost-shared initiatives, in various priority markets around the world.

For the 2005/06 fiscal year, the process of deciding where to invest funds for the 2005/06 funding period involves the following elements:

- **Not a Business Subsidy:**
  FII funding is a legitimate investment undertaken on behalf of the owners of the forest resource, and in no way represents a business subsidy.

- **Cost Sharing:**
  In the vast majority of cases, FII investments must be cost-shared with the BC forest industry and/or with the federal government.

- **Eligibility:**
  Project proposals are requested through a public tendering process to which industry associations, research institutes, academic institutions, and BC government ministries may apply. A detailed description of this funding process and proponent eligibility can be found on FII's Internet website at www.bcfii.ca .

- **Ongoing Strategy Development:**
  FII prepares an annual investment strategy to guide its investment decisions. This strategy will evolve, based on previous years' experience, information and knowledge developed about global forest markets, and with the input and guidance from the Minister of Forests, Forest Investment Council, Forest Industry, and other sources.

- **Evaluation:**
  A thorough evaluation of proponent proposals is undertaken, to assess eligibility and to prioritize projects for annual funding. All investment recommendations are reviewed to ensure consistency with FII's strategic objectives and annual investment strategy. Final funding decisions are made by the President of FII.

- **Accountability:**
  A comprehensive contract monitoring and audit process ensures the highest degree of accountability for public funds, and supports the achievement of tangible, meaningful results.

- **Centre of Knowledge:**
  To support maximizing the impact and return from project activities, and making appropriate decisions on investment priorities, FII recognizes the need for current, reliable, comprehensive and globally focused market information. This includes accumulating data and insights, filling in important gaps, and looking forward through new research activities. Subsequently, this market research is centralized through FII and becomes available to the entire BC forest sector, to support future plan preparation and decision making.

- **Direct Project Activities:**
  In some cases FII may initiate and deliver direct project activities. These activities will respond to market needs not otherwise addressed, and would be complementary to other funded proponent projects.

FII GUIDING PRINCIPLES:

For the 2005/06 fiscal year, Forestry Innovation Investment's (FII) project investments will be allocated based on a number of guiding principles.

1/ Market Strategies:

In addition to this overall Investment Strategy for 2005/06, FII will also guide investment decisions with individual market-by-market strategies. To date market strategies have been completed for South Korea, Taiwan and Japan. Additional work is planned for all other key markets in the immediate future. As these strategies are completed, proponents will be required to ensure their proposals and activities are consistent with the strategic direction and priorities set in these market strategies.

2/ Investments based on Knowledge and Excellence:

Roughly 20% of FII's investments will be focused on building knowledge and excellence, and investing in market intelligence and market research activities. Many of these activities will be proposed and completed by proponents; with a portion of this work initiated directly by FII.

The remaining 80% of FII's investments will be focused on marketing/product development projects; funding activities that will contribute to the achievement of FII's program goals. These activities will be firmly rooted in current, relevant, and comprehensive market information that provides a compelling business case for investing in the project.

3/ Excellence through Innovation:

Forestry Innovation Investment supports innovation and creativity, to achieve excellence. While established and accepted methods have an important role to play, so too does the development of new and innovative approaches. Based on sound market intelligence and planning, new and innovative approaches of achieving investment priorities will be encouraged.

4/ Generate a Positive Return on Investment:

FII expects that its investments will generate a positive return on investment for the industry and the province of BC. FII will establish as priorities those projects that contribute to generating a financial return that exceeds the initial investments made to support the initiative.

5/ Short and Long Term Investments:

As an annually funded program, FII must evaluate the results of its investments on an annual basis, and demonstrate the results those investments have achieved on a year by year basis. As a priority, FII will look for projects that will generate the desired impact and return on investment in the short term (ie. within one year).

FII recognizes, however, the need to take a long term perspective in funding some activities in developing or emerging markets. While a priority is still given to activities that generate shorter term results, FII is prepared to balance these investments with longer term, strategic investments where there is a compelling business case to do so.

Whether a short or longer term investment, all funding agreements are for a maximum of one year. Longer term projects will continue to require an annual proposal with project goals and objectives.

6/ Emerging and Existing Markets:

FII recognizes that there is considerable potential for increased activity or to enhance returns in BC's existing markets for forest products. These markets are where there is an existing demand for forest products, acceptance of BC products, and existing trading relationships. These markets represent the best short term potential for British Columbia, and as such roughly $^1/_2$ of FII's investments will be focused on activities in existing markets.

FII also understands that in order to diversify the industry in the longer term and to take advantage of new and developing opportunities, strategic investments in emerging markets are important. As a result of their importance and the longer term perspective to generate economic activity for BC, roughly $^1/_2$ of FII's funding will be available for emerging market activities.

7/ Primary and Secondary Manufacturing:

Recognizing that British Columbia is predominantly a producer of primary wood products (building products, etc), roughly 75% of FII's investments will be focused on marketing and market development activities for primary products.

British Columbia does have a considerable secondary or value-added manufacturing industry that continues to develop and prosper. Recognizing the importance of secondary manufacturing to the province, and the potential it has to add value to BC's forest products, FII anticipates spending roughly 25% of investments on marketing and market development activities for value-added products.

8/ Geographically-Balanced Investments:

As a priority, FII will fund projects that have a broad application to all parts of British Columbia. While it is recognized that the benefits of some FII funded

projects will extend to other parts of Canada, projects must be focused primarily on the BC forest industry. FII understands that British Columbia has two distinct aspects to its forest industry, Coastal and Interior/Northern BC. It is FII's intention to support project activities focused on each of the parts of the Province, where projects do not have a provincial scope in nature.

9/ Balance of BC Species:

FII's investments will be focused on the wood species grown and used for commercial products in British Columbia. The priority will be on species that currently represent commercial opportunities, and that have ready acceptance in international forest markets.

FII will entertain project proposals that explore or begin to commercialize lesser used BC wood species, as a part of its strategic activities designed to help further diversify the BC industry. All activities will require a compelling business case to secure FII funding.

IMPORTANCE OF THE BC FORESTRY SECTOR:

Despite ongoing diversification in the provincial economy, the forest products industry continues to play a major role in the economic well-being of British Columbia. In 2003, there were 78,300 direct jobs from the forest industry in B.C. and an estimated 156,600 indirect jobs (PwC 2004).

BC Exports

Forests cover about two-thirds (59 million hectares) of the province's land mass. Almost all of the wood in BC is softwood and is used to produce lumber, plywood, oriented strand board (OSB), particleboard, medium density fibreboard (MDF), shakes, shingles, newsprint, and pulp and paper products.

Forest products (commodity-type products, including pulp and paper, but excluding furniture, pre-fabricated homes and other specialty products) are the province's most important export commodity, accounting for $12.6 billion, almost half, of total provincial exports, and 8 percent of world exports of forest products in 2003.

British Columbia exports the majority of BC production. Three products account for over 99% of B.C. commodity wood products: softwood lumber is the major export product with a 93.7% export market share followed by OSB with 3.8% and softwood plywood at 1.6%. In 2003 BC represented over 40% of Canada's primary wood products production and 50% of Canada's exports by volume (see table below).

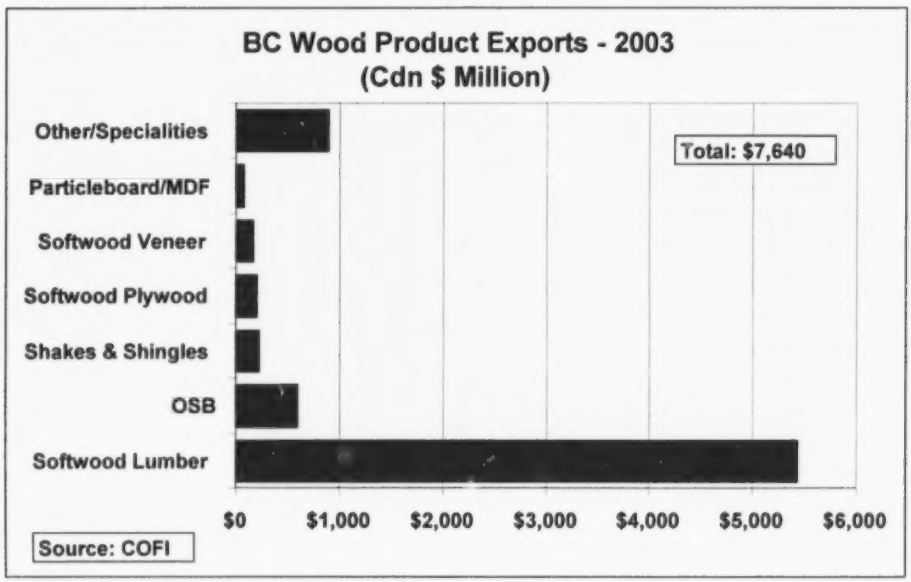
CANADA & BC: Primary Wood Products Production & Exports - 2003

	Units	Softwood Lumber	Softwood Plywood	OSB	MDF	Particle-board	Total
Total Consumption	(x000 m3)	27,468	1,748	2,388	674	2,145	34,423
Canada Total Production	(x000 m3)	77,699	2,183	10,201	1,232	2,991	94,306
Canada Exports	(x000 m3)	50,897	542	7,926	599	1,113	61,078
Canada Imports	(x000 m3)	666	107	114	41	267	1,195
BC Production	(x000 m3)	36,086	1,721	1,375	161	264	39,606
BC Exports	(x000 m3)	29,199	514	1,193	74	190	31,171
BC Share of Canada Prod'n	(%)	46%	79%	13%	13%	9%	42%
	(%)	57%	95%	15%	12%	17%	51%

Source: Statistics Canada, COFI, WOOD Markets

Products

B.C. wood product exports (value basis) show the importance of softwood lumber, as compared to panels or other products. Future growth will likely be based on commodity products, but some growth could be tied to niche opportunities for a variety of specialty and value-added products in both established and emerging markets.



British Columbia's value-added, or secondary manufacturing industry accounts for an important part of the provincial forest industry. As per the last published report on the value-added industry (Wilson, 2001), total value-added industry employment is 13,500 (20,191 when shake & shingle and panel board sectors are included).

- Average number of employees per firm: 34;
- Total value-added industry sales: estimated at $4.68 billion;

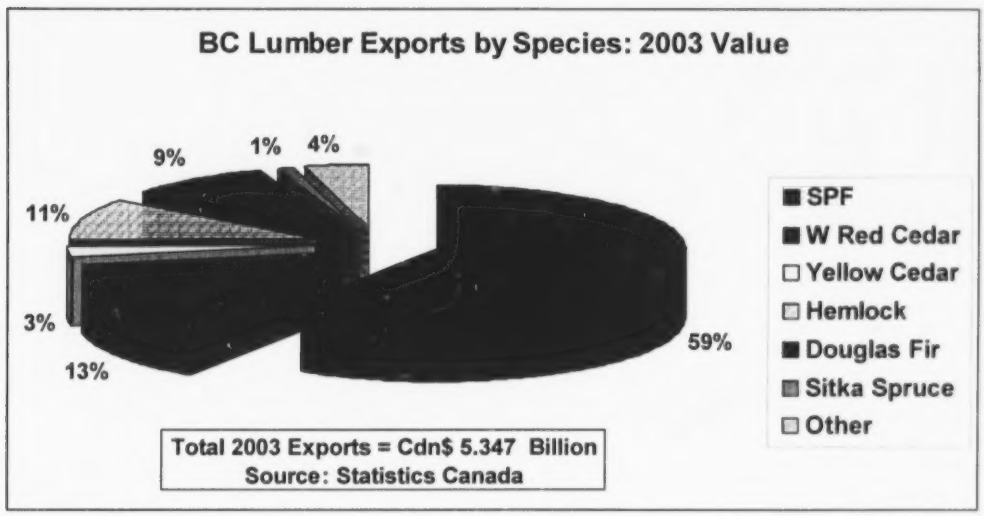
Some of the key economic drivers in BC's value-added industry include:

- **Cabinetry:** There are over 90 manufacturers of cabinetry in British Columbia, employing close to 900 workers and generating export revenues of almost $100 million.
- **Engineered Wood Products / Pre-fabricated Housing:** This sector boasts the largest number of manufacturers in the value-added wood products industry with almost 190 working plants. Current employment in this sector is listed near 3,700 employees, while sales revenue tops $650 million annually.
- **Furniture and Fixtures:** This category employs 1,100 craftsmen in about 75 facilities for revenues of $140 million.

- **Millwork:** Employing over 1,800 workers in BC, this sector generates $ 234 million in shipments from 120 manufacturing facilities in the province
- **Remanufactured Products (semi-finished):** Is the largest value-added sector employer in the province with close to 6,000 employees generating revenues of $1,590 million for just over 170 companies around BC.

Species

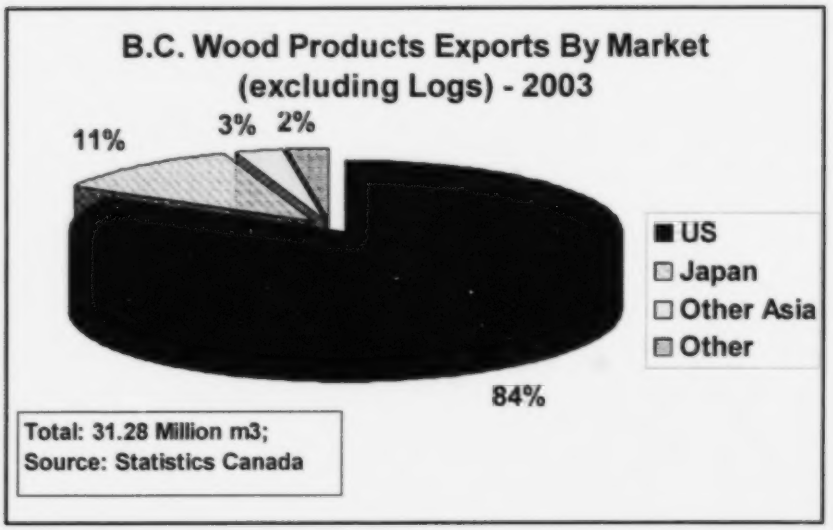
B.C. lumber exports (value basis) by species are led by SPF (spruce, pine fir). Western red cedar is second, followed by coastal structural whitewood (largely hemlock – balsam fir), and Douglas fir.



Key Markets

Commodity Wood Products

The U.S. market accounts for 83.5% of all B.C. commodity wood products exports and Japan represents 11.35% - both markets represent almost 95% of all wood products exports from B.C. Out of the remaining 5% market share, China and Hong Kong combined represent the third largest destination for B.C. exports (1.5%) followed by Taiwan (0.84%). These five markets (U.S., Japan, and "greater China") account for almost 97% of B.C. commodity exports. By comparison, all of Europe represents a mere 1.3%.



When the U.S. market is excluded, the importance of Japan emerges, as it represents almost 69% of total offshore commodity wood products exports.

When lumber is excluded, there are only two product/market combinations that have exports exceeding 10,000 m3 – softwood plywood and OSB exports to Japan both exceed this limit.

BC Commodity Products Exports by Market (Excluding the USA Market) - 2003 (m3)

Rank	Market	Softwood Lumber	Softwood Plywood	OSB	MDF/ Fiberboard	Particle-board	Total	Export Market Share
1	Japan	3,421,882	77,982	91,327	148	5,410	3,596,749	68.87%
2	Taiwan	263,508	-	724	1,977	-	266,209	5.10%
3	China, P. Rep.	205,401	575	9,895	4,368	-	220,239	4.22%
4	Hong Kong	162,549	-	-	1,241	-	163,790	3.14%
5	Australia	124,650	-	168	-	36	124,854	2.39%
6	Korea, South	107,967	46	6,900	77	-	114,990	2.20%
7	Saudi Arabia	110,562	-	-	40	-	110,602	2.12%
8	Italy	105,590	956	-	-	-	106,546	2.04%
9	United Kingdom	87,268	8,971	-	86	-	96,325	1.84%
	Top 10	4,589,378	88,530	109,014	7,937	5,446	4,800,305	91.92%
	All Europe	399,829	10,996	18	563	-	411,406	7.88%
	Total	5,005,812	90,844	109,395	10,652	5,446	5,222,149	100%
	Product Share	95.9%	1.7%	2.1%	0.2%	0.1%	100%	

Source: Stats Can

B.C.'s strength in export markets is still centered on the U.S. and Japan with other Asian countries offering the greatest potential for growth, especially in China and South Korea. India with its growing middle class and manufacturing sector is another market that could offer significant growth opportunities, but barriers such as high tariffs are inhibiting access to this market. Other markets may lie in newly developing countries and economies such as Vietnam, Thailand and the Philippines.

Specialty / Value-Added Wood Products

Generally, the U.S. market accounts for the majority of B.C. value-added wood product exports, followed by Japan and Europe. Demand for prefabricated, timber-frame and log homes, as well as millwork, mouldings, furniture, engineered wood and remanufactured products varies by market and product. DIY and renovation markets, as well as recreational or secondary home demands, are providing significant opportunities for wood components and wood finishing materials in existing markets. Depending on the product, some demand for B.C. product is also expected in some of the emerging markets such as China and Korea. However, opportunities for specialty and value-added products may be more difficult in the future as China's finished products industry continues with its rapid expansion. The opportunity for niche applications will be less subject to competitive pressures from Chinese producers until the volume potential increases.

PRODUCTS AND MARKETS: KEY ISSUES

The British Columbia forest sector is a major source of employment, the biggest market for new technologies, and the largest source of export sales. This has been the case for decades, and through sound forest policy and world leading forest practices, the sector will continue to play a vital role well into the province's future.

At the same time, future success is by no means guaranteed. There are significant challenges to be faced and overcome, including:

- **Access to the US Market:**

  The United States has shown a willingness to use trade barriers to limit access to Canadian imports. While the broader global trend over the last few decades has been towards a liberalization of trading relationships, the softwood lumber dispute with the U.S. remains a significant restraint on the success of BC's forest sector.

- **Global Supply:**

  Many countries are producing more forest products to compete with those produced in British Columbia. For decades, the world market for forest products was largely supplied by a handful of producing countries, with Canada accounting for a large share of the world's export trade. Today, many new countries are entering key BC markets as competitors, causing pressure on prices and severe competition for market share in many product categories.

- **International Competition:**

  Historically, BC has enjoyed a worldwide recognition as the supplier of choice for solid sawn lumber, panels and value-added grades of softwood lumber. With the increased number of international suppliers and increasing global volumes of

wood fiber available, BC's position within existing markets is continually challenged by international competitors.

The global forest industry is becoming increasingly dominated by large, multi-national players. While on a provincial or national scale BC's forest industry has comparatively large firms; on an international scale BC firms are still considered comparatively small players, even with recent consolidations. This can have an important impact on BC's ability to compete internationally, and for BC firms to capitalize on business efficiencies, trade networks, and access investment capital.

- **Substitute Products:**

  Many competitors (including concrete and steel, plastics, and engineered wood products produced in other supply jurisdictions) are constantly working to improve the qualities and attributes of their products. This includes efforts to work more closely with customers to understand and respond to their needs, to invent new and improved products, and to solve product or application problems. What was once disproportionately a commodity business is becoming a more complex mix of commodity and value-added opportunities and threats.

- **Environmental Considerations:**

  Some conservation groups and substitute product competitors have invested significant effort urging a reduction in consumption of forest products, on the basis that this would be advantageous from an environmental standpoint, despite the fact that the use of sustainably managed forest products represents an environmentally superior choice over other building materials.

British Columbians cannot afford to take these challenges lightly. Success in the future will require that an ever-greater premium is placed on sound marketing strategy and strong execution.

FII has committed to becoming a strong partner with industry, by investing in projects that are based on quality information, feature strong strategic underpinnings, and have the potential to build short and long term success for the province.

To support maximizing the impact and return from project activities, and making appropriate decisions on investment priorities, FII recognizes the need for ongoing comprehensive assessments of the strengths, weaknesses, opportunities and threats facing the BC forest sector. This important work will help guide FII investments, and FII will continue to enhance its information resources, as markets evolve.

STRATEGIC OBJECTIVES AND INVESTMENT PRIORITIES:

Consistent with FII's guiding principles for investments, Forestry Innovation Investment (FII) has identified the key market areas and key focus areas of activity that will reflect FII's investment priorities for 2005/06. These priorities will guide FII's funding cycle for 2005/06, and provide a basis from which to assess the degree to which proponent project proposals are consistent with FII's investment strategy. This strategy will also provide FII a key tool to use in assessing its own performance, and how FII investments are helping to contribute to FII's overall program and investment objectives.

Forestry Innovation Investment's 2005/06 International Marketing and Product Development Investment Strategy does not replace the need for individual proponents (either individually or collectively) and/or for FII to prepare individual market-by-market strategies / plans. Where individual market plans outline in detail the objectives and associated plans to achieve those objectives (over the short and longer term), FII's Investment Strategy is intended to provide a high level overview of International Marketing and Product Development priority areas for funding. FII has set a priority to work closely with industry, its representative associations and Natural Resources Canada to develop market strategies in all key forest product markets.

Like all FII investments, project proposals should be based on current market information, or be designed to compile this information to support project activities. Projects should focus on the areas where British Columbia may have a specific competitive or product advantage, and where the best opportunities exist for financial returns for the industry.

MOUNTAIN PINE BEETLE

FII recognizes the importance of the mountain pine beetle epidemic in the Interior of the Province, and the current and future impacts it may have on the industry – both in existing and emerging markets. FII anticipates receiving proposals that are designed to address market access issues, or pursue/explore commercially viable product development research / activities associated with mountain pine beetle impacted fibre. While FII places a strategic priority on the mountain pine beetle issue for 2005/06, all FII program and funding policies will apply to these activities/projects.

EXISTING MARKETS:

- The United States
- Japan
- Others: European Union, Australia/New Zealand

While market diversification is important, FII believes that existing forest product markets represent the best short term economic opportunities for British Columbia. FII places priority on the following existing forest sector markets - US, Japan, Europe, Australia/NZ.

The United States

The U.S. is the largest wood products market in the world and construction grade products dominate U.S. consumption, as well as B.C. exports. The U.S. is also the major market for B.C. value-added and specialty products.

British Columbia enjoys a long and established trading relationship in forest products with the United States. While the US is the most important market for BC forest products, the flows have been, and continue to be, challenged by increased US protectionism and increased global competition from international suppliers.

FII's ongoing objective in the US is to explore new niche markets or product opportunities and to encourage activities that stabilize or enhance existing product flows or species groupings.

Strategy

New opportunities can be found in the lucrative residential construction sector (single family and multi-family), but there are also existing and developing opportunities in the non-residential sector (including commercial, industrial and recreational construction).

Trends in North America for home renovations and consumer friendly installation packaged goods are representing considerable economic opportunities for manufacturers from all over the world. FII recognizes this as an important and growing trend in the US market, and has identified this as an area for proponent activities.

FII will continue to fund promotional activities to support existing product exports, as well as support specific market segment research to more clearly identify trends.

All project-specific promotional activities must be based on current market research and intelligence. Where market information does not exist or is not current/timely, FII will consider the compilation of this information a funding priority, to ensure that future marketing / promotional activities are focused and targeted appropriately.

Japan

Japan represents the most important export market for British Columbia forest products, outside of North America. While an established culture of wood usage exists in Japan, the marketplace and consumers in Japan are among the most demanding in the world. Japanese consumers are, however, still capable and willing to pay premium prices for preferred, high quality forest products. These characteristics, in conjunction with the established position of many BC producers and products, will continue to create opportunity for BC's primary and finishing products in Japan. Given the significance of the Japanese market, FII has identified it as a key existing market for 2005/06 investment activities.

The Japanese market is not without its challenges. Japan has suffered through a number of recessions over the past decade. Most of the country's leading economic indicators are either flat or only showing moderate signs of improvement. Japan imports a variety of wood products from around the world, and has established relationships with all key wood fiber exporting countries. Competitors are aggressively challenging the product segments that are supplied by BC producers, and represent a threat to BC's market share in Japan.

Strategy

The Housing Market Assurance Act that was established in 2000, is having a profound impact on the types of products now required in the Japanese marketplace. The Act requires warranties for up to 10 years for building materials, and this has lead the market to demand more dried and stabilized wood products. This change is both an opportunity and a threat to BC companies. Coastal firms processing and shipping green species are adjusting to the changes in the marketplace. FII recognizes this and considers it an ongoing priority to work closely with producer groups in this manufacturing segment to develop alternatives that reestablish or reposition specific products to existing or new markets within Japan, while responding to the evolving demands of the Japanese marketplace.

In past years, the insulation efficiency of houses in Japan has been much improved, but new indoor environment problems (e.g., indoor air pollution emitted from building materials, condensation, etc.) have become a concern. Chemically polluted air within the living environment and related symptoms of illness comprise a phenomenon known as the "sick house syndrome." It is the single greatest challenge facing Japan's housing industry today. Recent changes to the Japanese Building Standards Law and the new Housing Quality Assurance Act are addressing issues such as formaldehyde emissions to promote the construction of healthy housing.

Certain categories of building materials, including plywood, OSB and other panel products, and interior finishing materials of habitable rooms are affected by this focus on healthy housing. This has lead to performance and product labeling standards such as the F **** rating to categorize the acceptable standard reached by these products. FII sees these healthy housing trends as an opportunity to promote position BC's high performing and quality products as an answer to Japan's changing market needs.

Through various well established trade association offices and many ongoing initiatives, the British Columbia industry has had a significant presence in Japan for a number of years. As long as the business case to do so remains strong, FII anticipates continuing to support market based activities that help position BC as a preferred forest products supplier, in the eyes of building officials, importers, key influencers and consumers.

To guide future market development activities in Japan, FII, Natural Resources Canada, and BC forest industry associations (in consultation with BC forest companies and interests in Japan) prepared a market development strategy for Japan in 2004/05. This

strategy will help guide FII's funding decisions for Japan for 2005/06. Please contact FII for a copy of the market development strategy.

Proponents will be required to clearly demonstrate in their proposals, how their project activities are consistent with the market strategy, and how they will play a role in advancing the priority areas identified in the strategy.

Other Existing Markets:

In addition to the US and Japan, FII has identified the European Union and Australia/New Zealand as much smaller, but important existing markets for BC products. These markets represent more of a niche market opportunity for British Columbia. Given their ongoing consumption of wood products and the supply of certain types of products from BC, these markets have been identified as priority areas for funding as existing forest product markets.

Europe

After Japan, Europe (as a region) represents Canada's second largest offshore export market. Europe represents a major market for wood products as Europe has a strong wood culture and timber frame housing construction. However, Europe has eroded to a much smaller market since the early 1990s to the point it represents just over 1% of B.C. wood products exports.

The timber harvest and wood products production has expanded rapidly in Europe to the point that Europe has shifted from a net importer to a net exporter. This situation has limited the ability for North American exporters to access the European wood product markets.

Although the overall market trends show a decline in importance for BC wood products, Coastal species, namely Cedar, Hemlock and Douglas Fir have capitalized on market opportunities in Europe and developed into important "niche markets" for the Coastal industry. In many cases, these market niches represent high value markets for the more expensive grades of Coastal product.

Strategy

Monitoring of the EU member countries' harmonization of building codes into a single system is required to ensure that Canadian products are not disadvantaged or shut out.

A shift away from commodity-type products to specialty, niche or finished products appears to offer B.C. the most growth opportunities. The main product categories for growth should be in high grade appearance coast whitewood lumber, western red cedar products, and in specialty products such as doors, windows, mouldings, millwork and

flooring. Promotion of B.C.'s sustainably managed forests, forest practices and certification systems could also provide for improved opportunities against other exporters.

Australia / New Zealand

Australia is a modest sized market with increasing volumes of plantation timber and engineered wood products that have been steadily displacing B.C.'s Douglas fir. New Zealand is an even smaller market but is a larger exporter since it exports about two-thirds of its total production. Both countries have had a long history in the use of high grade western red cedar lumber for producing exterior doors and millwork products. B.C. has a high image for quality in both structural and western red cedar lumber.

Strategy

Douglas fir lumber and western red cedar remain niche species for the Australian and New Zealand markets, despite increasing competition from other species and engineered wood. Given the niche opportunities for select BC species in Australia/New Zealand, FII will consider modest funding requests to develop and expand key identified market opportunities.

EMERGING MARKETS:

- China
- Taiwan
- Korea

Forestry Innovation Investment recognizes the importance of the further diversification of British Columbia's forest industry, and as a priority will support market development activities to secure increased economic opportunities for British Columbia in emerging markets for forest products. FII is focusing its funding attention on the markets that appear to represent the best economic prospects for British Columbia (China, Korea and Taiwan).

For emerging markets in particular, FII has identified as a priority to support a wide range of market research activities. While these emerging markets may hold longer-term economic prospects for British Columbia, it is critical to ensure that we understand as much as possible about these markets to better assess the kinds of opportunities that they may come to represent, the issues that will likely be faced, and more about what must be done to position British Columbia as an important and readily accepted supplier of forest products.

Recognizing the infancy of most emerging markets, FII realizes the need to take a longer-term investment focus in these markets than it does in existing markets. As a result, the kinds of activities that FII will fund in emerging markets may differ from those in existing markets.

FII will support activities that contribute to British Columbia gaining **market access** to these emerging markets. It may include activities to overcome non-tariff trade barriers, the development of building codes and standards, or other projects designed to support the access and best utilization of BC's forest products in foreign markets.

FII recognizes the importance of **technology transfer**, as most emerging markets do not have a well developed wood consumption / construction culture. This may include the building of relationships, sharing of technical and product information, and supporting the transfer of North American construction technologies.

Where a compelling business case can be made to do so, FII may support **in-market representation** / resources. All FII cost-shared in-market representation must be coordinated with other FII funded representatives in the same location, with all representatives sharing common office space to maximize efficiency and working cooperatively to maximize effectiveness.

In all markets, but particularly in emerging markets, FII believes that it is critical that all British Columbia (and where possible Canadian) funded activities are coordinated as much as possible. Failure to provide consistent messaging and to ensure that investments are leveraged off of each other to maximize their impact, will only lead to inefficiency and confusion within the marketplace. All emerging market activities must coordinate their activities with other in-market activities, and work cooperatively with other FII funded project proponents as a condition of receiving (and continuing to receive) project funding.

China

Total annual consumption of wood in China for all purposes is about 370 million cubic meters. According to official data, about 65 percent of the wood is used for industrial purposes. The construction sector, furniture sector and paper sector account for about 90 percent of total industrial wood consumption. Many experts forecast that wood consumption in China will continue to increase in 2005. The reasons include:

- Rapid urbanization stimulates the housing and decoration sector.
- The countryside, a new house-building period is coming as the peasants' income increases.
- Public-led projects, including the 2008 "Green Olympics", 2010 Shanghai Expo and other infrastructure, public facilities, and park and recreation facilities continue to develop a need for wood.

China's housing starts and the need to create as many as 5,000 satellite cities will drive the demand for housing solutions (including 2x4 wooden houses developments).

However, wooden housing starts remain low pending further consumer and builder marketing and acceptance. China's housing building codes have been developed to include Canadian wood species in structural applications which is a big hurdle to overcome for future growth.
Russia was and continues to be the biggest timber supplier to China because of its competitive prices, especially when ocean freight rates are high (Russia transports mainly by rail and truck), and the similarity of Russian and Chinese tree species.

To date China has been a very small market for B.C. but the demand for imports is growing very rapidly – a trend that is expected to continue. B.C. softwood lumber exports, the key wood product into China, increased by almost 50% in 2003 as compared to 2002.

Strategy

It is recognized that additional work is required on a comprehensive market development strategy through cooperation and participation with Natural Resources Canada, the BC forest industry and associations active in China, as well as the Department of Foreign Affairs and International Trade through its Embassies and Consulates. While this work is being completed during the 4th quarter of 2004-05, Forestry Innovation Investment provides the following summary information -- which will guide FII's investment decisions in China.

The Chinese market has tremendous potential, particularly residential housing and product for remanufacture. Increasing disposable income means more Chinese consumers can afford their own homes. Wood-frame construction using BC wood products, if properly marketed, is a premium alternative to concrete-based construction. Multi-family dwellings, particularly townhomes, duplexes and low-rise apartment complexes, also represent a potentially large market for wood-frame construction. Composite construction – such as concrete walls and wooden trusses and roofs – represents a growth opportunity.

The overall strategy for China is to introduce Chinese consumers and entrepreneurs to the many uses and benefits of BC wood products. As local entrepreneurs find ways to develop business opportunities and add value using BC products, the demand for BC wood will increase. In addition to developing interest and demand for BC products, activities will be required to overcome any market access issues / technical barriers to trade.

FII has identified business opportunities for BC wood products in 3 key areas. Although initially focused on wood building products, FII's funded activities and overall strategy will support market growth in all 3 areas of opportunity. These areas of business opportunity include:

1/ Building products
2/ Value-added products
3/ Components or product for further remanufacture in China

Building Products: With the rapidly expanding residential housing market in China, and government policies stressing better quality and quantity of available choices, there is a significant opportunity for wood frame construction. As Chinese consumers come to understand the benefits of wood construction, and the misconceptions about durability and performance are overcome, wood frame housing can become an important building system in China. This will create new and expanded business opportunities for BC building products, including dimension lumber and panel products.

The potential market for wood construction is believed to reside in the following sectors:

- Villas
- Low-rise apartment blocks (multi-storey structures)
- Building restoration and renovations
- Hybrid construction (infill walls, truss roofs)

As BC is predominantly a producer of wood building products, supporting market development in this area is a key priority for the industry and for FII.

Value-added Products: BC has a growing and dynamic value-added wood industry. Although key markets are currently focused on the US and Japan, the industry has taken steps to expand its activities to new markets, including China.

As residential and commercial construction in China continues to expand, opportunities for value-added wood products and finishing products (both interior and exterior) will also grow. With China's recent moves to private ownership, from a centrally controlled system, its population now enjoys the pride of home ownership for the first time in over 50 years. Combined with increases in individual wealth and earnings, home renovations, improvements, and re-finishing are anticipated. While there will be significant competition from domestic-produced products in China and other low cost Asian producers, some business opportunities and high-end niche markets are anticipated for BC producers.

Components or Products for Further Remanufacture: China has become the largest recipient of foreign investment, with companies from around the world setting up business operations in China. Initially focused in manufacturing or business services for re-export, many businesses are now focusing on China's rapidly expanding domestic marketplace.

China has become a significant consumer of wood products, for its manufacturing and packaging industries. China is now amongst the largest furniture manufacturer in the world, drawing investment and business interests from around the globe. China is fast becoming a preferred, low cost manufacturing hub for many industries, consuming wood for production of specialty products or for packaging and wooden pallets.

One of the objectives of FII's funded activities in China, will be to help link BC's wood species with the manufacturing opportunities available in China. This could be higher value, appearance grade products, or low grade products for re-manufacture. Although we must maintain the maximum amount of value-added manufacturing in BC to support

BC companies, this must be balanced with the global shift in manufacturing taking place to low cost producers, like China.

Key Activities

All activities must be focused and closely coordinated, and should build upon the other activities underway in the marketplace, like the Dream Home China demonstration project or other proponent funded activities.

Priority activity areas for FII funding include:

- **Market research**
  B.C.'s presence to date in China is growing but there is a major learning curve ahead in many product areas due to the regional nature of the market. This includes both basic and advanced market research from codes and standards to understanding the market and end user requirements, including opportunities with technology transfer (i.e., 2x4 house construction techniques in single and multi-family housing construction), the introduction of new products such as pre-fabricated housing and specialty wood products, and consideration for applications into traditional roof and wall construction systems that currently utilize concrete or steel.

- **Market access**
  - **Codes and standards (building and fire codes)**
    While China has a long history of using wood-based construction, the emphasis recently has been on concrete-based structures. Zoning, building/fire codes, engineering and construction expertise, architectural experience, developer interest, and consumer awareness are all oriented towards concrete. Establishing a viable market for wood-based products means that all of these factors – regulations, expertise, market demand - must be dealt with through a coordinated and sustained strategy promoting the use of wood in residential construction.

    A close presence to monitor and influence Chinese building codes and standards, as well as phyto-sanitary standards is required to ensure that B.C./Canadian wood products are not excluded from certain applications. For example, fire code challenges have been standing in the way of expanded use of wood in construction in China. The harmonization of the two main fire codes in China is required to support the relaxing of tougher GBJ-16 regulations

  - **Training and technology transfer**
    There is a need for a coordinated approach to increase the capacity and knowledge of key influencer groups in China to utilize and specify BC wood products and species. FII encourages BC-based associations to work cooperatively and implement a comprehensive program to address key training and technology transfer priorities. FII commissioned a study –

released in December 2004 that reviewed current needs and activities and identified priorities for training and technology transfer moving forward.

- **Quality assurance and maintenance** – quality wood-based construction and finishing will ensure strong performing product and satisfied consumers. There is a need to improve construction quality in China to ensure that WFC market growth is sustainable and not endangered by quality problems.

- **Promotional activities** – ongoing promotion of BC forestry industry and products

- **Major marketing and communications campaign**
  FII has undertaken background market research on key influencer groups and audiences, including focus groups and preliminary data analysis which is readily available to industry partners.

  In order to engage the key audiences and communicate information on BC's products and species and the benefits of wood-frame construction, FII is encouraging and industry-led approach - collaboratively across sectors – for a significant marketing and communications program.

  Designed to communicate key messages, attract visitors to the Dream Home China structures, and encourage the expanded use of BC wood products, FII would like to work with partners to considerably accelerate the recognition and demand for BC wood products in China through an integrated communications initiative.

- **In market staffing**

Korea

Korea has been identified as a market that holds business opportunities for British Columbia forest products. While still a developing market, a number of BC companies have been shipping products into Korea for a number of years, and it is believed that further upside business opportunities exist.

To guide future market development activities in Korea, FII, Natural Resources Canada, and BC forest industry associations (in consultation with BC forest companies and interests in Korea) prepared a market development strategy for Korea in 2003/04. While it is anticipated that additional work will be required as market development activities take shape and further market research and information becomes available, this strategy will guide FII's funding decisions for Korea for 2005/06. Please contact FII for a copy of the market development strategy.

Proponents will be required to clearly demonstrate in their proposals, how their project activities are consistent with the market strategy, and how they will play a role in advancing the priority areas identified in the strategy. Activities and proposals should be commensurate with market opportunities, and clearly identify the market trends and dynamics they wish to capitalize on

Taiwan

Taiwan has represented a small market for BC forest products is believed to hold modest future potential. However, to date the opportunities or the scope of their future potential in Taiwan have not been well quantified.

To guide future market development activities in Taiwan, FII, Natural Resources Canada, and BC forest industry associations (in consultation with BC forest companies and interests in Taiwan) prepared a market development strategy for Taiwan in 2004/05. While it is anticipated that additional work will be required as market development activities take shape and further market research and information becomes available, this strategy will guide FII's funding decisions for Taiwan for 2005/06. Please contact FII for a copy of the market development strategy.

Proponents will be required to clearly demonstrate in their proposals, how their project activities are consistent with the market strategy, and how they will play a role in advancing the priority areas identified in the strategy. While the growth opportunity in Taiwan is modest, FII will consider priority activities with a strong business case for investment.

Other Emerging Markets:

Forestry Innovation Investment recognizes that there are other emerging markets for wood products around the world, or markets that may represent future potential. Although not the primary focus of its activities for 2005/06, FII will continue to explore wood markets trends in other parts of the world, and may complete market research as deemed appropriate in these areas.

While FII may consider proponent proposals in other emerging markets (non-priority areas), funding will only be made available where the proponent provides a compelling business case for activities. FII funding will also be allocated to priority market areas first, prior to considering proponent funding for other emerging markets.

CONCLUDING COMMENTS:

This document represents Forestry Innovation Investment's 2005/06 International Marketing and Product Development Investment Strategy. While not intended to summarize FII's or the BC Industry's detailed strategies or plans in any one market, this plan provides a high level overview of the funding priorities FII has established for the upcoming fiscal year. Based on the investment guidelines and investment priorities established in this document, FII will assess funding proposals and make investment decisions for the 2005/06 funding year.

FII will also utilize this document as an important input into Forestry Innovation Investment's performance management framework. This performance management framework will provide the structure FII uses to evaluate and assess the success of the projects that it funds, and the results and return that these investments generate. The framework also provides the structure through which FII will evaluate its own success in achieving its program objectives, as the investment agent of the Government of British Columbia for forest sector marketing and product development initiatives.

This investment strategy is intended to provide prospective funding proponents with a summary of the market areas and the kinds of activities that FII has established as priorities to receive funding for 2005/06. It is FII's intention to support project activities that are consistent with the guidelines and investment focus as outlined in this document. Proponents submitting funding proposals through FII's 2005/06 competitive call for proposals process are required to have read and identified clearly in their proposal, how their project plan is consistent with the focus and intent of this investment plan.
Any proposals that are outside of the focus of this strategy will require significant supporting information and a very compelling business case and rationale as to why FII funding should be approved; if they wish to receive any consideration for funding.

FII will continue to receive input from the BC forest industry, government, and other key stakeholders throughout the fiscal year. As market conditions change, or emerging opportunities arise, FII may alter the approach identified in this strategy to pursue new opportunities as they may develop. Any changes in priorities will be communicated with FII's key stakeholders and funding recipients/partners.